



THIS REPORT CONTAINS ASSESSMENTS OF COMMODITY AND TRADE ISSUES MADE BY USDA STAFF AND NOT NECESSARILY STATEMENTS OF OFFICIAL U.S. GOVERNMENT POLICY

Required Report - public distribution

**Date:** 10/17/2014

**GAIN Report Number:** UP1438

## **Ukraine**

### **Dairy and Products Annual**

#### **Annual**

**Approved By:**

Jorge A. Sanchez, Agricultural Attaché

**Prepared By:**

Alexander Tarashevych, Agricultural Specialist

**Report Highlights:**

Production and exports of cheese in 2014-15 is expected to decrease significantly due to Russia's import ban. Processors will have no choice but to switch to butter and non-fat dried milk production and rely on export sales. Imports of dairy products will also decrease due to significant currency devaluation. Local whole dairy products production will remain stable – supported by domestic demand for this staple food.

**Data included in this report is not official USDA Data. Official USDA data is available at <http://www.fas.usda.gov/psd>**

### **Executive Summary:**

After some stabilization in the livestock headcount in 2012-13, animal numbers resumed a decreasing downward trend in 2014. However, similarly to previous years, the decline in milk production caused by a two-percent drop in dairy cow headcount will be offset by an increase dairy cattle output. The total milk yield is expected to increase marginally in 2014 and suffer a negligible decrease in 2015. The decrease is expected to take place in response to Ukraine's largest market closure in history with neighboring Russia that was followed by a devastating crash in raw milk prices.

As outlined in the recent GAIN Report, on July 28, 2014, the Russian Federal Veterinary and Phytosanitary Service (Rosselkhoz nadzor) delisted all Ukrainian dairy producers effectively halting exports of cheese, butter and dried dairy products. The action shutdown Ukraine's major dairy export market valued at \$353 million in 2013. While Ukraine's industry has weathered similar export bans imposed by Russia in the past (first one for cheese was in 2005); the magnitude of this particular ban was unique in that it was inclusive of all exportable dairy products. Because the ban was purely driven by political forces, it is unlikely export restrictions will be suspended any time in the near future.

The domestic market for dairy products will remain strong as many dairy products are viewed by local consumers as a staple food ingredient. The share of high-margin products is expected to decrease, while inexpensive whole dairy products will likely gain popularity fueled by negative macroeconomic trends. In 2014, Ukraine's GDP will exceed an eight-percent decline (second worst result in the last 15 years) with an inflationary rate nearing 20 percent. Real disposable income is expected to grow by two percent.

Political turmoil did not allow for the signing of the Association Agreement with the European Union (EU) in November 2013. However, the EU unilaterally opened its market under the terms and conditions outlined in the Deep and Comprehensive Free Trade Agreement (part of the Association Agreement). So far, Ukraine was not able to benefit from liberalized trade due to its lack of proper legislative framework and the inability of many out-of-date dairy processors to match EU sanitary requirements. However, the Directorate-General for Health and Consumers (DG SANCO) audits were recently completed, and limited market access (presumably for whole dairy products) could be granted in the near future.

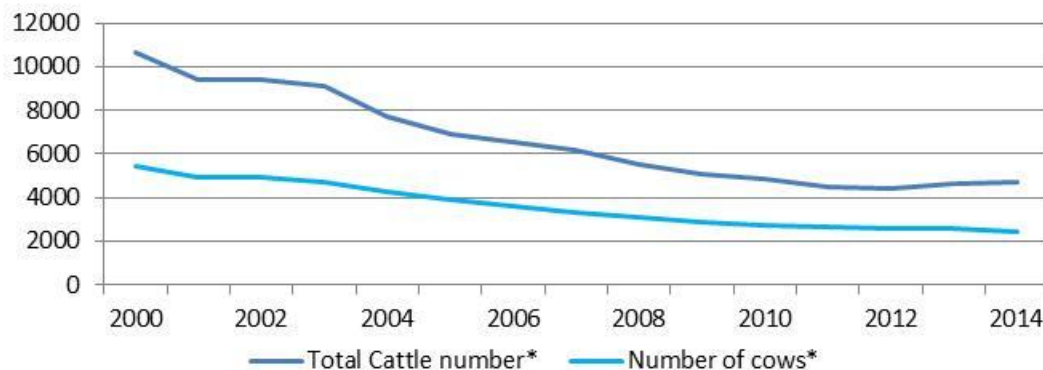
Note: All 2013 figures and 2014 forecasts include Republic of Crimea data. However, the State Statistics Service reported that flow of data from Crimea is now interrupted, so some changes are possible in future GAIN reports.

### **Production:**

#### Raw Milk

Milk production in Ukraine is expected to grow moderately in 2014. The overall increase will be close to one percent. The number of cows will decline in both the household sector (by over four percent) and in industrial farms (by over two percent) while per cow milk yields will continue to increase.

## Cow Headcount Continued to Decrease in 2014

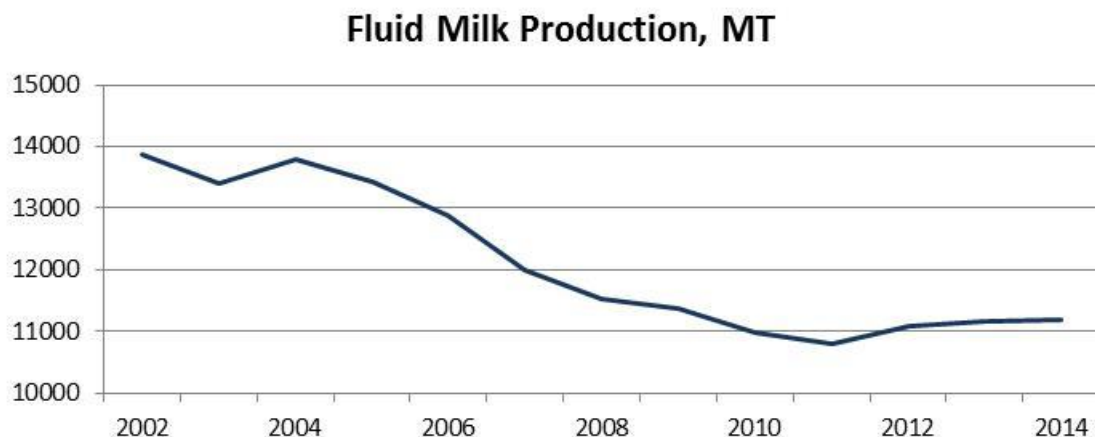


*\*As of January 1st of each year*

*Source: State Statistics Service of Ukraine, FAS Kyiv projection*

Historically the raw milk market exhibited rather inelastic behavior showing resilience to trade and price shocks. Many households view milk production as a safety net allowing them to sustain incomes during periods of economic hardship. A significant portion of milk is consumed within the household, sold to neighbors, or in open-air markets in nearby towns. Both industrial producers and households realize that the number of cows can decrease easily, while increases can take years. Many industrial farms would rather accept temporary losses in hopes of an improvement in their economic situation. When the cattle headcount decreases, producers increase the slaughter of animals with the lowest output, which reduces the impact on total milk production even further. For these reasons, the 2015 forecast is more optimistic as the decline in raw milk supply will only be marginal.

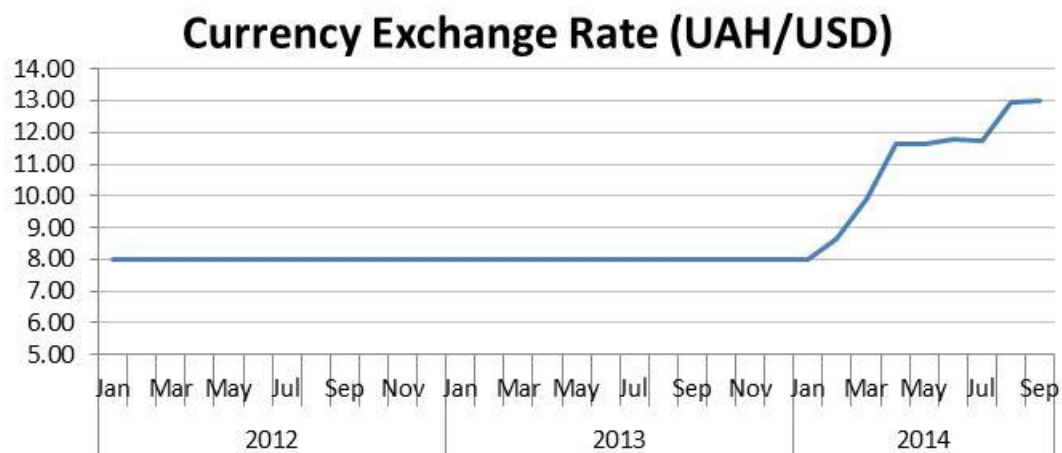
Raw milk production in Ukraine continues to be concentrated mainly in household farms (which accounted to about 78 percent of total production in 2014). Milking practices in household farms frequently encounter health-related quality irregularities, and as such, have a reduced procurement price. In addition, household milk supplies are difficult to control: backyard milk production is seasonal with significant production drops during winter and peaking during the spring-summer months. Household produced milk also has a higher real production cost in comparison to industrial farms. Milk collection, cooling, and transportation constitute additional problems with household production.



Source: USDA official data, FAS Kyiv projection

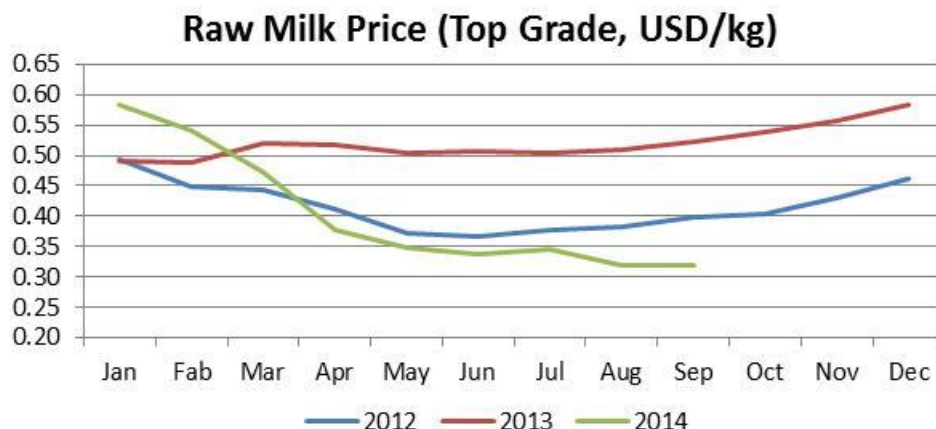
However the long term trend remains: competition with large industrial milk producers will slowly drive household-produced milk away from the organized markets. Industrial milk is of superior quality. It is also the product of choice for producers of whole dairy products and especially cheeses.

Ukrainian currency (Hryvna - UAH) denominated milk prices held at the same level as in 2013. However significant currency devaluation throughout 2014 had a devastating impact on the domestic price. UAH lost over 60 percent of its value in just seven months.



Source: National Bank of Ukraine average exchange rate;

The impact of the devaluated currency led to the crash of real milk prices.



Sources: Ukrainian Association of Milk Producers; MilkUA.info; FAS own calculations  
 \* Prices (\$/KG) for the top grade milk procured from industrial farms

Although substantial currency devaluations gave producers of cheese and dried milk products a temporary advantage over their foreign competitors, in fact the economic crisis brought about greater challenges than benefits to industrial dairy producers. The development of profitable production facilities which heavily relies on external financial sources were either unavailable or became too expensive. Many companies encountered problems maintaining their day-to-day operations due to delays with money transfers in a troubled banking system.

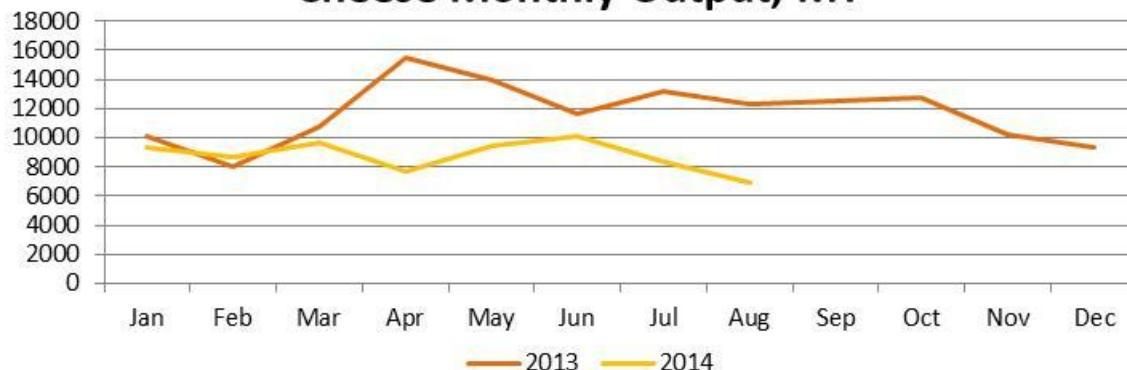
Many inputs used by dairy producers are of foreign origin; therefore, these companies face a situation where their hryvna-denominated input costs appreciated. Producers import a significant share of veterinary drugs, feed additives, equipment, feeders, ventilation equipment and farm machinery. Ukraine's commercial dairy industry can supply only a limited number of basic equipment, so a quick switch to locally produced machinery is highly unlikely, while the majority of input costs (such as feed, electricity, labor costs and other related items) will remain priced in hryvnas.

Household production, on the other hand, is less vulnerable to currency fluctuations. Low-cost milk producers rely on their self-produced feed input and can easily limit consumption of foreign inputs.

### **Production of Cheese, Butter and Dry Milk Products**

Being a net exporter of dairy products, in 2014, Ukraine must adjust its production according to international market demand. In many cases, production was oriented toward a sole buyer – the Russian Federation. Ukrainian cheese producers suffered from multiple trade restrictions introduced in early 2014. While some of them were lifted; some remained in place until the full-scale politically motivated import ban was introduced in July 2014. Normal business planning in such a hostile trade environment is complicated, if possible at all, which resulted in a gradual decline in cheese production. The post-ban production statistics were unavailable by the time this report was drafted, but further production decreases seem unavoidable.

## Cheese Monthly Output, MT



Source: State Statistics Service of Ukraine

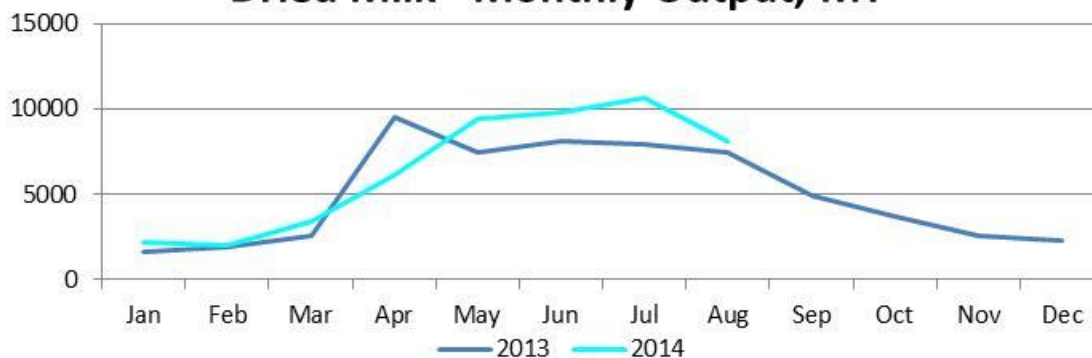
The availability of inexpensive milk (after the currency devaluation) enabled Ukrainian producers to switch to butter/non-fat dried milk (NFDM) production couple. Both products show moderate production increases. Similarly to cheese production, these trends are expected to rev up by the yearend.

## Butter Monthly Output, MT



Source: State Statistics Service of Ukraine

## Dried Milk\* Monthly Output, MT

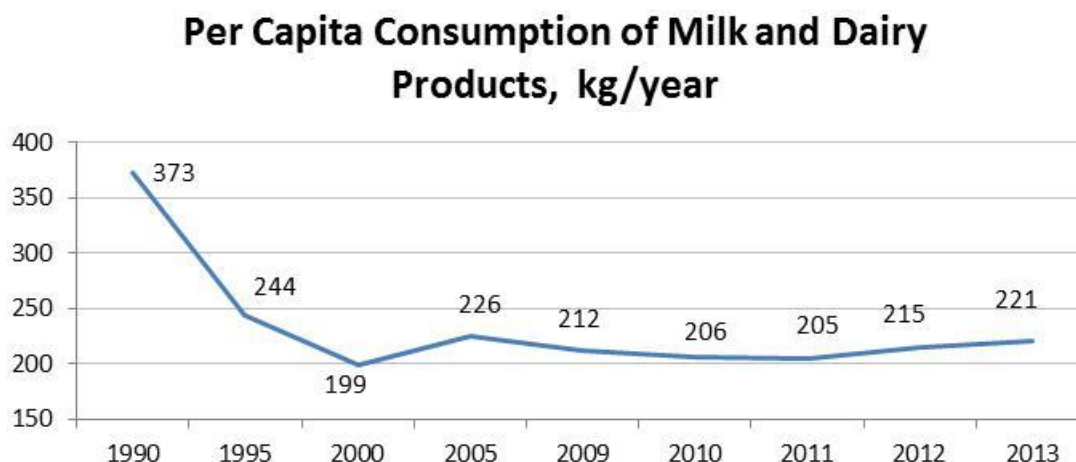


\* NFDM +WDM combined

Source: State Statistics Service of Ukraine

## Consumption:

The Ukrainian economy entered 2014 in recession that turned into a full-scale political and economic crisis. The GDP contraction in 2014 is expected to reach eight percent with an inflation rate nearing 20 percent. International financial institutions forecast a negative GDP growth for 2015 with no clear forecast for 2016. Although the economy took a deep dive, real disposable income rates are expected to grow anywhere between two to three percent in comparison to 2013. This had a stabilizing influence on dairy consumption. Ukrainians continue to spend over half of their disposable income on food products.



Source: *State Statistics Service of Ukraine*

Affluent Ukrainian consumers who are dissatisfied with the inconsistent quality of domestically produced cheeses and butters often purchase high value-added imported products providing some opportunities for imported dairy products. However in 2014, many middle-income consumers are expected to modify their preferences and switch to domestically produced dairy products as currency devaluation has priced out consumers from comparatively expensive imports. In private conversations with dairy producers, they stated that they expected to utilize currency devaluations to expand their market share. The price advantage is expected to last between a year to a year and a half.

The PSD numbers were changed to match official production and trade statistics. The new PSD includes carry-over stocks officially reported by producers of the State Statistics Service on a monthly basis. This carry-over stock does not include trade stocks and products procured for the State Reserve of Ukraine. Official ending stocks will be used in PSD's tables in the future as their impact on consumption and trade can be significant.

## Trade:

In 2012/13, the high raw milk price decreased competitiveness for Ukrainian dairy product exports. Nonetheless, Ukraine continued to supply significant quantities of cheese and non-fat dried milk abroad. The majority of these products were exported to Former Soviet Union (FSU) markets with Russia as the leading consumer.

However, the situation changed drastically in 2014 when Russia started to delist Ukrainian dairy suppliers. Many cheese manufacturers had to terminate cheese production and quickly reorient production towards butter, NFDM, or whole dairy products. On August 1, 2014, Russia [officially](#)



[delisted](#) all Ukrainian dairy facilities, thus closing the market to these products. For more information see [UP1424 GAIN](#) Report. The major export articles included cheese, butter and NFDM. The total market loss amounted to \$353 million (for 2013).

#### **Ukraine's Exports of Dairy Products\***

Partner Country	Quantity, MT			% Share			% Change
	2011	2012	2013	2011	2012	2013	2013/2012
World, Butter	1172	477	3245	100.00	100.00	100.00	579.94
Russia, Butter	595	61	2330	50.78	12.76	71.81	3725.12
World, Cheese	77075	64243	57528	100.00	100.00	100.00	- 10.45
Russia, Cheese	68079	56103	49861	88.33	87.33	86.67	- 11.13
World, NFDM	22274	26241	12402	100.00	100.00	100.00	- 52.74
Russia, NFDM	5398	11138	5439	24.23	42.44	43.86	- 51.16

Source: State Statistics Committee of Ukraine

\*FAS commodity definitions and HS Codes are used

#### **Value of Exported Dairy Products\***

Partner Country	1000 United States Dollars			% Share			% Change
	2011	2012	2013	2011	2012	2013	2013/2012
World, Butter	5492	1969	18805	100.00	100.00	100.00	854.90
Russia, Butter	3083	246	14200	56.13	12.51	75.51	5662.63
World, Cheese	437329	349808	358250	100.00	100.00	100.00	2.41
Russia, Cheese	389089	306444	314153	88.97	87.60	87.69	2.52
World, NFDM	68938	72023	49338	100.00	100.00	100.00	- 31.50
Russia, NFDM	19379	34071	24788	28.11	47.31	50.24	- 27.24
World, Total Value	511760	423801	426394	100.00	100.00	100.00	-0.611895
Russia, Total Value	411551	340762	353141	80.41879	80.406	82.82	-3.63293

Source: State Statistics Committee of Ukraine

\*FAS commodity definitions and HS Codes are used

The Russian ban had a destructive impact on the Ukrainian dairy industry. Dairy processors undermined their margins and depressed raw milk prices. Although significant, the impact should not be overestimated. The official export statistics for nine months of 2014 are not yet available. However Ukraine's industry association stated that dairy producers were able to export dairy products valued at \$515 million in 2014 which is a higher than the \$506 million value in 2013. The profitability is a bit lower though. Note, the total trade volume increased from 159,400 MT in 2013 to 174,900 MT in 2014.

The collapse in trade to Russia was softened by an increase in exports to other destinations. Significant quantities continue to be exported to the Commonwealth of Independent States (CIS) countries. Moldova, Kazakhstan and Belarus are becoming the major buyers of Ukrainian dairy products. The last two countries are members of the Russian-commanded Customs Union and enjoy a free trade regime with the Russian Federation in exchange for their political obedience. In many cases Ukrainian product has substituted locally-produced products of the same quality and price range, as these are exported to Russia.

Currency devaluation had a negative impact on the domestic market for high quality imported dairy products. Trade in expensive cheese and whole milk products are expected to drop by 20-25 percent by the end of 2014.

The Deep and Comprehensive Free Trade Agreement between Ukraine and the EU is not yet fully implemented. When implemented, it will provide a better competitive position to EU exporters than their U.S. competitors. The EU will be able to increase supplies under the negotiated TRQ



system, although Ukrainian suppliers are unlikely to benefit in the short run, due to veterinary and sanitary restrictions. Some observers blame Russia's strong opposition and demand of trade consultations as a way of sabotaging the implementation EU integration efforts. Possible trade bans by the Russian Federation imposed on both Ukrainian and EU exports delayed the ratification of the FTA agreement in the Ukrainian Parliament.

In early 2014 in order to support Ukraine's economy and to avoid Russia's sanctions, the EU provided Ukrainian producers with a six-month (May to November) unilateral market access on the terms agreed upon in the FTA agreement. (Note: Ukraine did not open its dairy market to the EU.) The access is expected to expand for another 14 months. In this way, EU producers will not be able to utilize their import TRQ until January 1, 2016, which is when the full scale implementation of the FTA is expected. Exports to the EU are not expected to resume in the foreseeable future. Despite the available import TRQ, Ukrainian dairy producers lack veterinary and sanitary approvals from EU authorities. DG SANCO inspection attended Ukraine in September. The results of the audit are not yet available. Industry sources communicate that the largest concern from inspectors was unorganized milk supplies from the households entering into commercial channels, as safety of the raw milk cannot be assured.

### Cheese

Cheese will remain an important exportable agricultural commodity in 2014. However close to the yearend it will significantly drop due to Russia's import ban. Cheese exports to non-CIS countries are highly unlikely due to completely different consumer preferences in the EU, African or Middle-Eastern markets. Exports of cheeses from Ukraine are expected to be at an all-time low level.

### **Trade in Cheese and Cheese Products (January-July)\***

Partner Country	Unit	Quantity			% Share			% Change
		2012	2013	2014	2012	2013	2014	2014/2013
World Total	T	32044	33566	16393	100.00	100.00	100.00	- 51.16
Including:								
Russia	T	28177	29311	11716	87.93	87.32	71.47	- 60.03
Kazakhstan	T	2983	3377	2408	9.31	10.06	14.69	- 28.68
Belarus	T	0	0	1450	0.00	0.00	8.84	0.00
Moldova	T	666	663	558	2.08	1.97	3.40	- 15.85
Azerbaijan	T	107	126	135	0.33	0.38	0.82	7.25

*\*Trade statistics prior to trade ban introduction*

*Source: World Trade Atlas*

### Butter

In the absence of reliable butter, market producers had no choice but to rely on butter + NFDM couple. Industry believes that currency devaluation and consecutive raw milk real price drops will provide them with a temporary competitive advantage on the world market. Exports of butter are expected to grow in 2014/15.

### **Trade in Butter (January-July)\***

Partner Country	Unit	Quantity			% Share			% Change
		2012	2013	2014	2012	2013	2014	2014/2013
World	T	231	600	2241	100.00	100.00	100.00	273.57
Including:								
Russia	T	21	310	1460	8.97	51.70	65.16	370.82
Armenia	T	0	0	191	0.00	0.00	8.51	0.00
Moldova	T	56	125	170	24.09	20.79	7.58	36.20
Belarus	T	0	0	115	0.00	0.00	5.14	0.00
Georgia	T	0	16	107	0.00	2.60	4.77	586.70

*\*Trade statistics prior to trade ban introduction*

*Source: World Trade Atlas*

#### Nonfat Dry Milk /Whole Milk Powder

NFDM is tied to butter production and will follow its trade trend.

#### **Trade in NFDM (January-July)\***

Partner Country	Unit	Quantity			% Share			% Change
		2012	2013	2014	2012	2013	2014	2014/2013
World	T	15313	5036	18077	100.00	100.00	100.00	258.96
Including:								
Kazakhstan	T	860	150	3019	5.62	2.98	16.70	1912.67
Bangladesh	T	425	100	1925	2.78	1.99	10.65	1825.00
Russia	T	7236	1723	1848	47.25	34.22	10.22	7.24
Algeria	T	900	80	1150	5.88	1.59	6.36	1337.50
Nigeria	T	400	475	1115	2.61	9.43	6.17	134.74
Georgia	T	277	386	1013	1.81	7.67	5.60	162.40
Egypt	T	150	25	881	0.98	0.50	4.87	3424.00
Belarus	T	0	0	780	0.00	0.00	4.31	0.00
Armenia	T	294	134	720	1.92	2.66	3.98	437.24
Moldova	T	1005	691	552	6.57	13.71	3.05	- 20.13
Syria	T	725	175	525	4.73	3.48	2.90	200.00

*\*Trade statistics prior to trade ban introduction*

*Source: World Trade Atlas*

Production and exports of whole dried milk (WDM) are expected to remain stable in 2013-15. Ukrainian producers consider WDM production and exports less attractive as availability of seasonal milk is decreasing and the price remains high throughout the entire season. The availability of more attractive butter + NFDM couple does not allow for significant profitability of WDM production even as Russia delisted cheese production facilities.

Information on state purchases of dried milk products is unavailable, although the Agrarian Fund (GOU operated agency) was granted limited funds to conduct interventions in the middle of 2014. However market players report the lack of real purchasing activity by the Fund. State interventions are restrained by the lack of real financing and not likely to be significant in 2014-15.

Trade estimates for 2013 were revised to converge with official statistics. The trade forecast for the remaining months of 2014, as well as for 2015 remain subject to political and trade policy changes.

#### **Statistical Tables**

##### **Fluid Milk PSD Table\***

Dairy, Milk, Fluid	2013		2014		2015
	Market Year Begin: Jan 2013		Market Year Begin: Jan 2014		Market Year Begin: Jan 2015
	USDA Official	New Post	USDA Official	New Post	New Post
Cows In Milk	2,554	2,554	2,540	2,545	2,400
Cows Milk Production	11,160	11,189	11,220	11,200	10,800
Other Milk Production	310	299	320	310	310
Total Production	11,470	11,488	11,540	11,510	11,110
Other Imports	7	6	12	6	6
Total Imports	8	6	12	6	6
Total Supply	11,477	11,494	11,552	11,516	11,116
Other Exports	0	8	0	8	8
Total Exports	10	8	10	8	8
Fluid Use Dom. Consum.	5,667	5,316	5,692	5,908	5,908
Factory Use Consum.	4,800	4,918	4,900	4,400	4,100
Feed Use Dom. Consum.	1,000	1,252	950	1,200	1,100
Total Dom. Consumption	11,467	11,486	11,542	11,508	11,108
Total Distribution	11,477	11,494	11,552	11,516	11,116

*\*These are not official USDA numbers*

#### Cheese PSD Table\*

Dairy, Cheese	2013		2014		2015
	Market Year Begin: Jan 2013		Market Year Begin: Jan 2014		Market Year Begin: Jan 2015
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	0	0	0	9	10
Production	147	140	150	100	90
Other Imports	18	16	23	9	6
Total Imports	18	16	23	9	6
Total Supply	165	156	173	118	106
Other Exports	60	58	60	20	10
Total Exports	60	58	60	20	10
Human Dom. Consumption	105	89	113	88	88
Other Use, Losses	0	0	0	0	0
Total Dom. Consumption	105	89	113	88	88
Total Use	165	147	173	108	98
Ending Stocks	0	9	0	10	8
Total Distribution	165	156	173	118	106

*\*These are not official USDA numbers*

**Butter PSD Table\***

<b>Dairy, Butter</b>	<b>2013</b>		<b>2014</b>		<b>2015</b>
	<b>Market Year Begin: Jan 2013</b>		<b>Market Year Begin: Jan 2014</b>		<b>Market Year Begin: Jan 2015</b>
	<b>USDA Official</b>	<b>New Post</b>	<b>USDA Official</b>	<b>New Post</b>	<b>New Post</b>
Beginning Stocks	0	0	0	4	14
Production	90	93	92	115	110
Other Imports	12	13	14	10	3
Total Imports	12	13	14	10	3
Total Supply	102	106	106	129	127
Other Exports	1	3	1	4	6
Total Exports	1	3	1	4	6
Domestic Consumption	101	99	105	111	111
Total Use	102	102	106	115	117
Ending Stocks	0	4	0	14	10
Total Distribution	102	106	106	129	127

\*These are not official USDA numbers

**Nonfat Dry Milk PSD Table\***

<b>Dairy, Milk, Nonfat Dry</b>	<b>2013</b>		<b>2014</b>		<b>2015</b>
	<b>Market Year Begin: Jan 2013</b>		<b>Market Year Begin: Jan 2014</b>		<b>Market Year Begin: Jan 2015</b>
	<b>USDA Official</b>	<b>New Post</b>	<b>USDA Official</b>	<b>New Post</b>	<b>New Post</b>
Beginning Stocks	2	2	2	2	2
Production	52	52	52	55	55
Other Imports	1	2	3	2	2
Total Imports	1	2	3	2	2
Total Supply	55	56	57	59	59
Other Exports	16	12	20	37	37
Total Exports	16	12	20	37	37
Human Dom. Consumption	37	42	35	20	20
Other Use, Losses	0	0	0	0	0
Total Dom. Consumption	37	42	35	20	20
Total Use	53	54	55	57	57
Ending Stocks	2	2	2	2	2
Total Distribution	55	56	57	59	59

\*These are not official USDA numbers

**Dry Whole Milk Powder PSD Table\***

Dairy, Dry Whole Milk Powder Ukraine	2013		2014		2015
	Market Year Begin: Jan 2013		Market Year Begin: Jan 2014		Market Year Begin: Jan 2015
	USDA Official	New Post	USDA Official	New Post	New Post
Beginning Stocks	0	0	0	0	0
Production	11	10	11	12	12
Other Imports	1	1	2	0	0
Total Imports	1	1	2	0	0
Total Supply	12	11	13	12	12
Other Exports	0	0	0	2	2
Total Exports	0	0	0	2	2
Human Dom. Consumption	12	12	13	10	10
Other Use, Losses	0	0	0	0	0
Total Dom. Consumption	12	12	13	10	10
Total Use	12	12	13	12	12
Ending Stocks	0	0	0	0	0
Total Distribution	12	12	13	12	12

\*These are not official USDA numbers